STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6120

Tariff filing of Central Vermont Public Service Corporation requesting a 12.9% rate increase, to take effect July 27, 1998	)))

Docket No. 6460

Tariff filing of Central Vermont Public Service Corporation requesting a 7.6% rate increase, to take effect December 24, 2000	)))

PREFILED TESTIMONY OF
WILBUR L. ROSS, JR.
ON BEHALF OF THE
VERMONT DEPARTMENT OF PUBLIC SERVICE

March 9, 2001

Summary: Wilbur L. Ross, Jr.'s conclusions on CVPS remaining an investment grade issuer.

Prefiled Testimony
of
Wilbur L. Ross, Jr.

Q. PLEASE DESCRIBE YOUR QUALIFICATIONS

A. I have been an investment banking professional for more than 35 years after earning an MBA with Distinction from Harvard and an AB from Yale. I am a Chartered Financial Analyst and a member of the New York Society of Security Analysts and of NYSSA's Committee on Alternative Investments. I have advised on the restructuring of more than $200 billion of assets including Public Service of New Hampshire, EUA Power Corp., Northeast Utilities, El Paso Electric and PJM Interconnection LLC. In Vermont, I was the financial advisor to Vermont Electric Cooperative and successfully obtained for VEC a Baa rating while the Company was in bankruptcy and placed privately with insurance companies the Notes that funded VEC's exit from bankruptcy. I also have served as the Department's expert witness in the recent Green Mountain Power rate case. I am a former member of the Joint Legislative Commission on an Energy Policy For New York State and was an advisor to the Long Island Power Authority in its privatization. For 24 years, I was Executive Managing Director of Rothschild Inc. prior to forming my own firm on April 1, 2000. Both at Rothschild and subsequently, I have had extensive dealings with the rating agencies.

Q. WHAT WAS YOUR ASSIGNMENT FROM THE VERMONT DEPARTMENT OF PUBLIC SERVICE?

A. I was retained early this year to recommend to the Department what level of rates and write-off could be sustained by Central Vermont Public Service without causing the company to be downgraded below investment grade by the rating agencies. I also was retained to consider the implications of a value recapture mechanism.

Q. WHAT SOURCE DOCUMENTS DID YOU USE?

A. They are attached as Exhibit DPS-WLR-1, Exhibit DPS-WLR-2, and Exhibit DPS-WLR-3. All were provided by Central Vermont Public Service Company as allegedly confidential documents and accordingly are being filed under seal at this time.

Q. WHAT ADJUSTMENTS, IF ANY, DID YOU MAKE TO CVPS' FORECASTS?

A. Based on information provided us by the Department, we adjusted CVPS' projected load growth up to 1% per year and we assumed that 40% of the incremental revenues would be additional cash profits. We also assumed that any actual increase in O&M costs beyond approximately [redacted] would be fully passed on to ratepayers, as would municipal and other taxes in excess of a combined total of [redacted]. I have also accepted the Company's projections for non-utility and CVEC net income. Finally, we assumed that all incremental earnings would be subject to cash tax payments of 40%.

Q. HAVE YOU PREPARED AN EXHIBIT REFLECTING THESE CHANGES?

A. We have. It is Exhibit DPS-WLR-4.

Q. HAVE YOU REACHED A CONCLUSION AS TO A COMBINATION OF RATE PATH AND WRITE-OFF THAT WOULD ENABLE CVPS TO REMAIN AN INVESTMENT GRADE ISSUER.

A. I have. It is attached as Exhibit DPS-WLR-5.

Q. WHAT DOES IT SHOW?

A. Exhibit DPS-WLR-5 takes the five key financial ratios which Standard and Poor's applies to electric utilities with average business prospects and a BBB rating and compares them to CVPS during 2001, 2002 and 2003.

In the first ratio, pre-tax interest coverage, CVPS is modestly below the benchmark in 2001 and 2002 and is above the benchmark in 2003. In the second, total debt to total capital, CVPS is well within the limit even after a write-off of $25,000,000 pre-tax, or $15,000,000 after-tax. In the third, funds from operations coverage of interest, CVPS is below in 2001 and 2002, but closely approaches the target in 2003. As to the fourth and fifth ratios, funds from operations as a percentage of total debt and net cash flow as a percentage of capital expenditures, CVPS is well above the required levels in all three years.

The relatively weak coverage of interest in 2001 and 2002 is importantly due to the fact that CVPS is significantly over-borrowed in those years in the sense that it has far too much cash, namely [redacted] and [redacted], respectively, and therefore suffers from a negative interest rate arbitrage. The rate on CVPS' debt naturally exceeds the rate it can earn on short-term investments. While this creates a technical issue relative to the particular rating criteria, it also means that CVPS is extraordinarily liquid during the period and we therefore are confident that the liquidity plus the strength of the other ratios would offset the shortfalls in the interest coverage.

We are also confident that a one-time $25,000,000 write-off that permanently resolves the Hydro Quebec contract costs would give the financial community confidence in the regulatory environment, just as the recent resolution of the Green Mountain Power case did. The balance sheet ratios resulting from such a write-off would remain strong relative to the relevant criteria.

Q. HAVE YOU ALSO ANY SUGGESTION FOR HOW TO STRUCTURE A RECAPTURE MECHANISM TO ASSURE THAT GENEROUS TREATMENT OF HYDRO QUEBEC DOES NOT TRANSFER TOO MUCH VALUE FROM RATEPAYERS TO STOCKHOLDERS?

A. Yes, I believe that a recapture mechanism should have several characteristics so as to achieve that purpose while not interfering with access to capital markets. It should be simple so that it does not cause undue confusion in the market place, and it should be tied to a merger and acquisition ("M&A") type transaction so that it does not interfere with CVPS' ability to access the capital markets in the normal course. An instrument that was triggered just by stock price action could have a chilling effect on the market. In contrast, one tied to M&A would simply be a means of allocating part of the acquisition premium back to ratepayers. In my opinion, a provision that the lesser of $20 million or 20% of the premium above book value obtained in any takeover of CVPS within the next, say, ten years, would not affect access to capital markets and would have little or no impact on the price of CVPS stock.

Q. DOES THAT COMPLETE YOUR PREFILED TESTIMONY.

A. Yes, it does.